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PINNACLE PETROLEUMS LTD.

ANNUAL REPORT 1973



HEAD OFFICE:

1470 Bow Valley Square One
202 - 6th Avenue S.W.
Calgary, Alberta
T2P 2R9

DIRECTORS:

R. L. Borden, Calgary, Alberta
W. C. Bumpers, Phoenix, Arizona
J. P. Floyd, Calgary, Alberta
W. H. Molle, Toronto, Ontario
J. R. Schmid, Calgary, Alberta

OFFICERS:

W. H. Molle, President
J. R. Schmid, Executive Vice-President
and General Manager
J. P. Floyd, Secretary

AUDITORS:

Peat, Marwick, Mitchell & Co.
Calgary, Alberta

SOLICITORS:

McLaws & Co.
Calgary, Alberta

BANKERS:

The Bank of Montreal, Main Branch
Calgary, Alberta

REGISTRAR:

Montreal Trust Company,
at its offices:
Calgary, Alberta
Vancouver, B.C.
Toronto, Ontario
Montreal, Quebec

LISTING:

Toronto Stock Exchange

ANNUAL MEETING:

The Annual Meeting will be held at 10:00
a.m., Thursday, August 16, 1973 at the
Jasper Suite, Calgary Inn, 4th Avenue
and 3rd Street S.W., Calgary, Alberta.

To the Shareholders:

I am sure you will be pleased in reviewing the results of our past year's operations to see that production, revenue and cash flow were the highest in our Company's history.

In addition to the improved operating results, the proven and probable oil reserves of the Company were increased by a very significant 43%. This increase is attributable to the inclusion of certain of the Company's producing properties in units and secondary recovery projects.

Oil and gas exploration and development activity also increased during the year with the Company participating directly or indirectly in 15 wells, 9 of which were wildcats. The wildcats resulted in 2 gas wells, 1 suspended oil well and 6 dry holes. The 2 gas discoveries have not been fully evaluated but it would appear that neither will add significantly to the Company's reserves or revenue. The remaining 6 development and infill wells were all completed as oil producers.

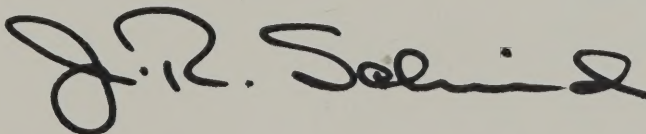
In minerals exploration, the Company completed several extensive geochemical programs on its copper prospect in the Chibougamau area of Quebec. Plans are being made for further exploration on these properties.

A review of the consolidated financial Statements will show that the financial position of the Company remains healthy. In an effort to more fairly represent this position, we have this year removed a wholly-owned subsidiary, Midalta Oil Company Limited, from the consolidated financial Statements of the Company, and the effect of this deconsolidation is discussed in the financial section of this report.

With the increase in demand for petroleum and natural gas, the price for these commodities is beginning to reflect their true value as an energy source. This strengthening of price has already resulted in an increase in exploration activity not only in Western Canada but worldwide. It is Pinnacle's intent to participate fully in this renewed activity.

A continuation of these encouraging trends should ensure an optimistic outlook for the Company in the coming year.

Very truly yours,

A handwritten signature in black ink, appearing to read "J.R. Schindler". The signature is fluid and cursive, with the first letters of each name being capitalized and prominent.

July 18, 1973.

Oil and Gas Exploration - Canada

ALBERTA

In the **Majorville** area on a block of some 9,400 acres in which the Company holds a 12½% working interest, a Basal Quartz oil discovery was drilled in 1972. This discovery has subsequently been abandoned as a non-commercial oil well. A further three-well farmout arrangement was made on the property during our last fiscal year and all three wells resulted in dry holes. A further option was granted and a Viking gas discovery was drilled directly offsetting the Company's acreage. Further drilling will be required to establish the extent of the field.

The Company, with partners, drilled a wildcat well in the **Leahurst** area on a block of 6,400 acres in which the Company holds varying interests. The well resulted in a dry hole but further drillable prospects exist on the block.

In the **Crossfield** area, an Elkton gas discovery was drilled by another Company on a quarter section in which Pinnacle holds a 2% mineral interest. Until an Energy Conservation Board hearing is held in regard to pooling of the spacing unit, Pinnacle will not have access to the well information.

SASKATCHEWAN

The Company concluded an optional farmout agreement in the **Forget** area of Saskatchewan and the earning test resulted in an oil well which was abandoned as being non-commercial after producing small amounts of oil. Subsequent to this, a seismic option was granted in regard to acreage adjoining the well to the north. The results of the seismic program were disappointing and the option well was not drilled.

A further farmout was granted in the **Browning** area and the earning well was dry and abandoned at a depth of 4,240 feet in November, 1972. An additional option in regard to this farmout was not exercised.

In the **Kisbey** field, a development well was drilled in December, 1972 on acreage under which the Company holds an overriding royalty. This well was completed as an oil producer flowing 63 barrels of oil per day.

Oil and Gas Exploration - North Sea

Pinnacle Petroleums Ltd., through its subsidiary Grizzly Exploration (U.K.) Ltd., holds a 6¼% interest in Block 48/23 in the southern portion of the North Sea. A seismic option was granted on this Block and 150 miles of seismic were completed by the optionee in January, 1973. We are now awaiting the election of the optionee on whether they intend to drill a well on the Block on the basis of their seismic interpretation. If such a well is drilled, it must be completed prior to September, 1973 pursuant to our farmout agreement.

Minerals Exploration

The Company has completed its \$100,000 geochemical and geophysical exploration program on the mining claims at Chibougamau, Quebec. These 31 claims stretch some 3½ miles along the Grenville fault zone and adjoin the Icon Sullivan Joint Venture producing copper mine to the southeast.

By the expenditure of the \$100,000, the Company has earned a 60% interest in a new Quebec corporation, Grenville Exploration Limited-Exploration Grenville Limitee, which was formed by the Company for the purpose of holding these claims. Grenville is currently formulating plans for the further exploration of these properties.

Production

Production rates had an increase of 8% last year and the Company produced 121,181 barrels of oil during the 12 month period. As this production was during a period of high allowables and demand, it probably represents the maximum rate for our non-unit production, but unit production should continue to increase during 1973.

A 20% price increase for crude oil during the year has brought our average sales price to slightly over \$3.00 a barrel. While this price increase contributes directly to revenue without increasing operating costs, the additional revenue will be offset to a substantial amount by increased royalties payable in 1973 in all of the Provinces in which Pinnacle operates.

During the year, certain of the Company's producing properties were included in the Pembina Belly River "B" South Unit and infill drilling and water injection has commenced. The Company was already a participant in the Belly River "C" Unit and this Unit also commenced water flood operations during the year. Commencement of these secondary recovery projects has resulted in an increase of the Company's proven and probable oil reserves of 43%. These additional reserves not only directly increase the asset value of the Company but also will result in increased production rates and revenues.

Financial

The operations of the Company during the past fiscal year showed a continuing improvement with revenues up 9% and cash flow up 12½%, the highest in the Company's history. Operating costs, however, were also up during this period, mostly attributable to remedial work required by the regulatory bodies on some of our marginal producing properties. As these marginal wells become uneconomic to operate, they are being abandoned and operating costs should be down substantially during 1973.

An important change to notice this year is that the accounts of Midalta Oil Company Limited, a wholly-owned subsidiary, have not been included in the consolidated financial Statements of the Company. Midalta has not been an operating entity for several years and it is the opinion of the Board of Directors and management that it does not form a part of our consolidated group of companies on a continuing basis.

Midalta has a liability of slightly over \$1,000,000 arising out of an indebtedness and this liability in the past has been incorporated in the balance sheet of Pinnacle Petroleums. The end result of the deconsolidation is to remove this liability from the Company's consolidated financial Statements. As our lawyers have advised that Pinnacle and its other subsidiaries do not have any obligations, guarantees or commitments to or on behalf of Midalta, the deconsolidation should more fairly and accurately represent the financial position of Pinnacle Petroleums.

The balance sheet of Midalta Oil Company Limited is included in Note 1 of the financial Statements.



Consolidated Balance Sheet

March 31, 1973

(with comparative figures for 1972)

ASSETS

	1973	1972 (as restated)
CURRENT ASSETS:		
Cash	\$ 30,754	19,636
Short-term deposits	410,000	555,000
Accounts receivable	51,872	42,522
Prepaid expenses	3,659	1,967
Total current assets	496,285	619,125
NOTE RECEIVABLE INCLUDING ACCRUED INTEREST (Note 2)	245,982	224,500
DEFERRED ACCOUNTS RECEIVABLE	28,004	26,905
PROPERTY AND EQUIPMENT, AT COST LESS DEPLETION AND DEPRECIATION (Note 1):		
Petroleum and natural gas properties	1,457,995	1,327,738
Less accumulated depletion	725,056	643,577
	732,939	684,161
Production and other equipment	417,674	432,660
Less accumulated depreciation	302,045	307,851
	115,629	124,809
Mineral properties	96,536	64,079
Net property and equipment	945,104	873,049
OTHER ASSETS:		
Drilling and other deposits, at cost less amounts written off	42,756	42,756
Drilling rig held for sale — at cost less accumulated depreciation	16,344	22,800
Incorporation costs	5,401	5,401
	64,501	70,957
	<u>\$1,779,876</u>	<u>1,814,536</u>

See accompanying notes.

LIABILITIES

	<u>1973</u>	<u>1972</u> (as restated)
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	\$ 36,006	41,263
Total current liabilities	<u>36,006</u>	<u>41,263</u>
DEFERRED INCOME (Note 2)	74,219	52,588

SHAREHOLDERS' EQUITY:

Share capital (Note 4):

Authorized 7,000,000 shares without nominal or par value		
Issued 5,380,895 shares	5,774,799	5,774,799
Deficit	4,105,148	4,054,114
	<u>1,669,651</u>	<u>1,720,685</u>

On behalf of the Board:

"W. H. MOLLE", Director

"R. L. BORDEN", Director

<u>\$1,779,876</u>	<u>1,814,536</u>
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Consolidated Statement of Earnings

Year ended March 31, 1973
(with comparative figures for 1972)

	1973	1972 (as restated)
REVENUES:		
Crude oil and gas sales and royalties	\$ 280,271	251,244
Interest and other income	38,827	41,625
	<u>319,098</u>	<u>292,869</u>
EXPENSES:		
Operating	130,567	94,813
General and administrative	136,494	151,826
	<u>267,061</u>	<u>246,639</u>
CASH FLOW FROM OPERATIONS	52,037	46,230
DEDUCT:		
Depreciation	36,627	49,274
Depletion	78,284	83,142
	<u>114,911</u>	<u>132,416</u>
Net loss before extraordinary items	62,874	86,186
EXTRAORDINARY ITEMS:		
Recovery of advance to non-consolidated subsidiary previously written off	8,131	(39,900)
Gain on sale of production equipment	3,709	—
	<u>11,840</u>	<u>(39,900)</u>
Net loss	<u>\$ 51,034</u>	<u>126,086</u>
LOSS PER SHARE:		
Loss before extraordinary items	\$.01	.02
Net loss	<u>\$.01</u>	<u>.02</u>

See accompanying notes.



Consolidated Statement of Source and Application of Funds

Year ended March 31, 1973
(with comparative figures for 1972)

	<u>1973</u>	<u>1972 (as restated)</u>
SOURCE OF FUNDS:		
Cash flow from operations	\$ 52,037	46,230
Net proceeds from sale of properties and equipment	17,737	8,356
Repayments on note receivable	—	46,077
Increase (decrease) in advances to non-consolidated subsidiary	8,131	(39,900)
Sundry	—	927
Total funds provided	<u>77,905</u>	<u>61,690</u>
USE OF FUNDS:		
Purchase of property and equipment	195,488	80,688
Total funds applied	<u>195,488</u>	<u>80,688</u>
DECREASE IN WORKING CAPITAL	117,583	18,998
WORKING CAPITAL, AT BEGINNING OF YEAR	577,862	596,860
WORKING CAPITAL, AT END OF YEAR	<u>\$460,279</u>	<u>577,862</u>

See accompanying notes.

Consolidated Statement of Deficit

Year ended March 31, 1973
(with comparative figures for 1972)

	<u>1973</u>	<u>1972 (as restated)</u>
Balance, at beginning of year, as previously reported	\$5,010,791	5,685,783
Deduct accumulated deficit of subsidiary deconsolidated in 1973 (Note 1)	956,677	1,757,755
Balance, at beginning of year, as restated	4,054,114	3,928,028
Add net loss for year	51,034	126,086
Balance, at end of year	<u>\$4,105,148</u>	<u>4,054,114</u>

See accompanying notes.



Notes to Consolidated Financial Statements

March 31, 1973

1. Principles of Consolidation:

The consolidated financial statements include the accounts of Pinnacle Petroleum Ltd. and its wholly-owned subsidiary companies, Baldonnel Oil & Gas Ltd., Grizzly Petroleum Limited and Grizzly Exploration (U.K.) Ltd. The company has another wholly-owned subsidiary, Midalta Oil Company Limited (Midalta) which has not been included in the consolidated financial statements because in the opinion of the Board of Directors and management, this subsidiary does not form part of the consolidated group of companies on a continuing basis. Also Pinnacle Petroleum Ltd. and its other subsidiaries, do not have any obligations, guarantees or commitments to or on behalf of Midalta. The full amount relating to the investment in and advances to Midalta have been written off in the accounts of Pinnacle Petroleum Ltd. in previous years. For comparative purposes the figures for 1972 have been restated to remove the accounts of Midalta.

A summary of the financial position of Midalta as at March 31, 1973 is as follows:

Assets		
Cash		\$ 355
Overriding royalty interest, at estimated value		43,000
Agreement by D. Bruce Bullock & Associates Ltd. to assume liability of a demand loan (see below)	\$1,024,491	
Less allowance for loss	<u>1,024,491</u>	<u>—</u>
		43,355
Liabilities		
Demand loan and accrued interest due to Greyhound Leasing and Financial Corporation	\$1,024,491	
Due to Pinnacle Petroleum Ltd.	<u>669,430</u>	<u>1,693,921</u>
Shareholders' deficit		<u>\$1,650,566</u>

On October 16, 1972 an action was commenced by Greyhound Leasing & Financial Corporation against Midalta and another defendant claiming the amount of \$1,024,491 and costs. On April 3, 1973 Greyhound Leasing & Financial Corporation entered a judgment in the Supreme Court of Alberta against Midalta and the other defendant.

Counsel for Pinnacle Petroleum Ltd. has advised that Pinnacle is not liable for the judgment obtained by Greyhound Leasing & Financial Corporation against Midalta.

2. Note Receivable:

Under a renegotiated agreement dated May 19, 1972, the note receivable from Lenrice Engineering Ltd. (the Lenrice note) was due on or before December 29, 1972 and is now in default. The note bears interest at 10% per annum.

The Lenrice note is principally secured by a Chattel Mortgage on certain equipment having an estimated value of approximately \$25,000 and a promissory note from The Principal Group Ltd. (Principal Group note) in the amount of \$715,000. The note is due October 1, 1983 and bears interest at

8½% per annum payable monthly. The Principal Group note was assigned to the Company by Lenrice Engineering Ltd. under the agreement dated May 19, 1972 as collateral security for the payment of the Lenrice note.

The Principal Group Ltd. has refused to pay the monthly interest and the Company has commenced action against The Principal Group Ltd. claiming the arrears of interest and a declaration that it is entitled to payment of interest under the note. The action is at the Discovery stage.

In the opinion of the Company's solicitors, the Company has a good and valid Chattel Mortgage on the equipment, and is the holder in due course of the Principal Group note.

Interest earned on the Lenrice note to March 31, 1973 in the amount of \$64,869 has been included under the heading "Deferred Income" on the consolidated balance sheet pending final realization.

3. Stock Option:

The company has granted to an officer an option to purchase up to 25,000 shares in the capital stock of the company at \$.67 per share. The shares are exercisable 1/5 per annum on a cumulative basis, commencing April 7, 1972 and expiring on April 6, 1976 or in any event one year after termination of employment, whichever is earlier.

4. Income Taxes:

For income tax purposes the companies are entitled to claim drilling, exploration and lease acquisition costs and capital cost allowances (depreciation for tax purposes) in amounts which may exceed the related depletion and depreciation provisions reflected in the accounts. For 1972 the companies do not intend to claim excess capital cost allowances, but will claim the other specified deduction in amounts sufficient to eliminate taxable incomes, and expenditures remaining to be carried forward and applied against future taxable income are as follows:

Drilling, exploration and lease acquisition costs	\$1,779,895
Undepreciated capital cost	\$ 187,890

5. Remuneration:

The aggregate remuneration paid to directors and senior officers during the year was \$33,400.

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Pinnacle Petroleum Ltd. and subsidiary companies as of March 31, 1973 and the consolidated statements of earnings, deficit and source and application of funds for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the companies at March 31, 1973 and the results of their operations and the source and application of their funds for the year then ended, in accordance with generally accepted accounting principles which, except for the non-consolidation of a subsidiary company as explained in note 1 to the consolidated financial statements have been applied on a basis consistent with that of the preceding year.

Calgary, Alberta
May 3, 1973

PEAT, MARWICK, MITCHELL & CO.
Chartered Accountants

